No. 14054

IN THE

United States Court of Appeals For the Ninth Circuit

GEORGE SLAFF, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum opinion of the Tax Court (R. 40-43) is not officially reported.

JURISDICTION

The petition for review (R. 44-45) involves a deficiency in federal income tax and victory tax for the year 1943 and in federal income tax for 1944 in the amounts of $356.25 and $473, respectively. (R. 43.) [1]

[1] The year 1942 is also involved by reason of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

Taxpayer's returns for both 1943 and 1944 were filed on April 28, 1947, with the Collector of Internal Revenue for the Fifth District of New Jersey. (R. 39.) On June 19, 1950, the Commissioner of Internal Revenue mailed a notice of deficiency to the taxpayer advising of a total deficiency of $982.61. (R. 6-13.)[2] Within 90 days thereafter, on September 8, 1950, the taxpayer filed a petition for redetermination of the deficiency under Section 275 of the Internal Revenue Code. (R. 1-13.) On June 8, 1953, the Tax Court entered a decision finding a deficiency in income and victory tax for the year 1943 in the amount of $356.24 and in income tax for 1944 in the amount of $473. (R. 43.) The case is brought to this Court by a petition for review filed by the taxpayer on August 24, 1953. (R. 44-45.) Jurisdiction of this Court is invoked under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948. Venue is established by a written stipulation dated July 10, 1953,[3] agreeing that the decision of the Tax Court may be reviewed by this Court.

QUESTIONS PRESENTED

1. Whether the Tax Court correctly held that during the taxable years 1943 and 1944 taxpayer was not a *bona fide* resident of a foreign country or countries within the meaning of Section 116(a), Internal Reve-

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[2] Included in the amount of this deficiency was a deficiency in income tax for the year 1945 in the amount of $153.36, which is not in issue in this proceeding.

[3] This stipulation is not included in the printed record but forms part of the transcript of record on appeal.

nue Code, and, accordingly, that the income he earned in those years is not exempt from taxation.

2. Whether the Tax Court correctly held that the claim to exemption from taxation by the taxpayer resulted in an understatement of his gross income by more than twenty-five percent of the amount stated in the return, so that the five-year period for assessment and collection is applicable as provided in Section 275(c), Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations are set forth in the Appendix, *infra.*

STATEMENT

The uncontroverted facts as testified to by the taxpayer (R. 18-36) and as found by the Tax Court (R. 37-40) may be summarized as follows:

When taxpayer was classified by his draft board as 4-F, and he was not permitted to enlist in the armed services, he applied for overseas service with the American Red Cross, and was employed by that organization in June or July, 1942. He did not resign from the Federal Power Commission, where he was principal attorney, but obtained a leave of absence. He transferred real property in his name to his brother, and gave up his apartment in Washington, D. C., which was the only permanent residence taxpayer had maintained in the United States up to that time. (R. 30-32, 37-38.)

On orders of the Red Cross, taxpayer flew to England as a civilian passenger on a civilian airline, with

an American passport. From October to December, 1942, he served with the Red Cross in Greenock, Scotland, where he roomed with a private family. From December, 1942, to October, 1943, he was assigned to North Africa as executive aide or executive assistant to the delegate to North Africa. While in Algiers he had an apartment for a time and a house for a time. From October, 1943, to August, 1944, taxpayer served in Naples, Italy, as director of food supply for the Red Cross, where he shared an apartment with a correspondent of the National Broadcasting Company. From August to December, 1944, taxpayer was assigned to France, serving at Marseilles and Dijon. In Dijon he lived in an apartment. (R. 38.)

In December, 1944, taxpayer was returned to the United States to make appearances on behalf of the Red Cross. He left the employ of the Red Cross in April or May, 1945, when the Federal Power Commission requested taxpayer to return to its service, and he became chief counsel in charge of a nation-wide investigation of natural gas resources, a different capacity from that in which he had served before. (R. 38-39.)

When taxpayer went overseas, he intended to return to the United States after serving abroad whatever period of time might be required. He was advised by counsel that he was liable for taxes in England and France during the war, but he paid no taxes to either country. (R. 39.)

Taxpayer stated on the first page of his 1943 return under the heading "Income" (R. 25):

> American Red Cross—Overseas Sept. 1942 to Dec. 1944. Income received 3300; exempt under section 116 I.R.C.; therefore no taxable income.

After the word "Total" he wrote "None." A similar statement was made in the 1944 return. (R. 25-27, 39.)

The notice of deficiency was mailed to taxpayer June 19, 1950, more than three years after the returns were filed. Neither taxpayer nor anyone acting on his behalf filed any waiver extending the statute of limitations. The Tax Court held that taxpayer was not a bona fide resident of a foreign country or countries during either 1943 or 1944. The Tax Court held further that taxpayer omitted from gross income reported for 1943 and 1944 amounts properly includible therein in excess of twenty-five percent of the amount of gross income stated in the returns, thus applying the five-year statute of limitations under Section 275(c), Internal Revenue Code. From that decision taxpayer has appealed to this Court. (R. 39-40, 43, 44-45.)

SUMMARY OF ARGUMENT

1. Since taxpayer was not a *bona fide* resident of a foreign country or countries during the taxable years 1943 and 1944, his income, earned abroad during service with the American Red Cross, is not exempt from federal income tax. The legislative history of Section 116(a), Internal Revenue Code, shows that Congress, in exempting the income of a *bona fide* resident of a foreign country from taxation, meant more than one who is physically absent from the country. There is no showing that taxpayer maintained a real home and

assumed any obligations of a home in a foreign country, including the payment of taxes. Taxpayer admitted that he paid no taxes abroad and that he had always intended to return as soon as his Red Cross assignment was terminated. He had no history of long foreign service, and had not even resigned his prior position as a Government attorney, but only obtained a leave of absence. Taxpayer's status abroad was similar to that of war and defense workers, and the courts have uniformly held that such workers do not qualify as *bona fide* residents of a foreign country. In the light of the record, it is clear that the Tax Court was justified in finding that he was not a *bona fide* resident of a foreign country within the meaning of Section 116(a) of the Code and that his income in 1943 and 1944 was subject to taxation.

2. The deficiencies for 1943 and 1944 are not barred by the statute of limitations, since, although the notice of deficiency was mailed more than three years from the date on which taxpayer's returns were filed, the five-year period of limitations applies, expressed in Section 275(c), Internal Revenue Code. The legislative history of Section 275(c) shows that Congress intended it to apply to a case such as this where a taxpayer had omitted from gross income amounts properly includible therein in excess of twenty-five percent of the amount of gross income stated in the returns. Although taxpayer stated the amount he received overseas on the face of the returns, cases decided by this and other courts show that the mere presence of the amount received on a return does not amount to a re-

porting of the amount as taxable gross income. By the disclosure of the amount taxpayer earned, coupled with the claim of exemption, he did not report such sum as taxable gross income within the meaning of the statute. The Tax Court was correct in finding that he failed to report any gross income, and that he omitted from gross income reported for 1943 and 1944 amounts properly includible therein in excess of twenty-five percent of the amount of gross income stated in the returns. Therefore, the five-year statute of limitations contained in section 275(c), Internal Revenue Code, was properly applicable, and the notice of deficiency was mailed within the permissible period.

ARGUMENT

I

TAXPAYER WAS NOT A BONA FIDE RESIDENT OF A FOREIGN COUNTRY OR COUNTRIES DURING EITHER 1943 OR 1944

The Tax Court found that the taxpayer failed to show that he was a *bona fide* resident of a foreign country or countries during 1943 or 1944, and thus that his salary, earned for services with the American Red Cross performed in Scotland, North Africa, Italy, and France, was not exempt from federal income tax under Section 116(a)(1) of the Internal Revenue Code (Appendix, *infra*). The taxpayer has appealed, contending that under the facts the finding that he was not a resident is erroneous. (R. 48.) It is our position that the finding is fully supported by the record, applying the tests of residence supplied by the statute, the controlling Regulations, and the applicable decisions.

A. The Applicable Legal Principles

The exemption granted by Section 116(a) of the Code was first enacted in the Revenue Act of 1926, c. 27, 44 Stat. 9, as Section 213(b)(14). It was there extended to a person who was a "*bona fide* non-resident" of the United States for more than six months during the taxable year. This new provision was referred to as the "foreign trade exemption" and was intended to stimulate foreign trade. H. Rep. No. 1, 69th Cong., 1st Sess., p. 7 (1939-1 Cum. Bull. (Part 2) 315, 320); S. Rep. No. 52, 69th Cong., 1st Sess., pp. 20-21 (1939-1 Cum. Bull. (Part 2) 332, 348); H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 2 (1939-1 Cum. Bull. (Part 2) 361, 364).

The Senate amendments introduced into the language of the section the words " a *bona fide* nonresident of the United States" The debate of the amendment on the floor of the Senate shows that the exemption was intended to be accorded to persons physically absent from the United States for more than six months of the taxable year. See 67 Cong. Record, Part 4, p. 3781. In the light of the legislative history of the section, the Internal Revenue Service interpreted it to mean that residence in a foreign country was not necessary to the exemption from taxation. Mere physical absence from the United States for more than six months was sufficient. I.T. 2286, V-1 Cum. Bull. 52 (1926); S.M. 5446, V-1 Cum. Bull. 49 (1926); I.T. 2293, V-2 Cum. Bull. 33 (1926); G.C.M. 9848, X-2 Cum. Bull. 178 (1931); G.C.M. 22065, 1940-1 Cum. Bull. 100. See *Downs* v. *Commissioner,* 166 F. 2d 504, 507, 508 (C.A. 9th), certiorari denied, 334 U.S. 832.

The Commissioner of Internal Revenue applied this test from 1926 until 1942, when the section was amended, and the test applied by the Commissioner was upheld and applied in *Commissioner* v. *Swent,* 155 F. 2d 513 (C.A. 4th), certiorari denied, 329 U.S. 801; *Commissioner* v. *Fiske's Estate,* 128 F. 2d 487 (C.A. 7th), certiorari denied, 317 U.S. 635; and *Swent* v. *United States,* 162 F. 2d 710 (C.A. 9th). As was pointed out in *Commissioner* v. *Swent, supra,* p. 515, the word "resident" and its antonym "resident" are very slippery words, which have many and varied meanings, and the court construed the term 'nonresident" in the statute before it as requiring "actual physical absence from the United States for six months during the taxable year."

The statute was changed in 1942. Section 148 of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended Section 116(a) of the Internal Revenue Code to grant an exemption from federal income taxes to a citizen of the United States who "establishes to the satisfaction of the Commissioner that he is a bona fide resident of a foreign country or countries during the entire taxable year." This change came about in this way.

The bill passed by the House of Representatives eliminated the exemption entirely. Then hearings were held by the Senate Committee on Finance with respect to the repeal of Section 116(a). We believe that a statement by the Chairman of the Senate Committee on Finance in the course of these hearings is revealing of the intent of the Committee which wrote the 1942 amendment. Senator George stated (1 Senate Hearings on H.R. 7378, 77th Cong., 2d Sess., p. 743):

> Maybe we might shorten your testimony here on this point with this statement: I think it is recognized that the complete elimination of Section 116 (a) was not really intended, that it was not the primary purpose in the case of the bona fide, nonresident American citizen *who established a home and maintains his establishment and is taking on corresponding obligations of the home in any foreign country, but there is some need for treatment of this section, so that the technicians, American citizens who are merely temporarily away from home could be properly reached and dealt with for taxation purposes.* [Italics supplied.]

In the bill reported by the Senate Committee on Finance was inserted the provision which was subsequently enacted. It provided that the exemption should be extended to a citizen who "establishes to the satisfaction of the Commissioner that he is a bona fide resident of a foreign country or countries during the entire taxable year." The Senate provision was explained in S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 54, 116 (1942-2 Cum. Bull. 504, 505, 591), as follows:

> Under Section 116(a) of the Internal Revenue Code a citizen of the United States residing outside the United States more than 6 months during the taxable year is exempt from tax on his earned income from sources outside of the United States, except in the case of income paid by the United States or any of its agencies. This provision of the present law has suffered considerable abuse in the

case of persons absenting themselves from the United States for more than 6 months simply for tax-evasion purposes. To stop this abuse, the House bill repealed section 116(a).

From cases brought to your committee's attention, the complete elimination of this section would work a hardship in the case of citizens of the United States who are bona fide residents of foreign countries. For example, many employees of American business in South America do not return to the United States for periods of years. *Such persons are fully subject to the income tax of the foreign country of their residence.*[4] Your committee has adopted a provision which it is believed will effectively terminate the abuse of this section but at the same time will not unduly penalize our

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[4] The reference here is to testimony of several witnesses who were American citizens resident in various countries of Latin America for many years. Their testimony in summary was that Americans residing in those countries were fully subject to all taxes imposed by the countries; that the indirect taxes paid, for which the United States citizen received no benefits, were in general more burdensome and heavy than the income tax which was comparatively new in most of the Latin American countries; that although under Section 131 of the Code there would be a credit against United States income tax of the foreign income taxes paid, there was no credit allowed for other foreign taxes; and accordingly that a United States income tax on a foreign resident paying taxes to the foreign country would unduly burden him, particularly since in the foreign country he had to expend considerable additional sums to finance schools and hospitals to provide education and medical care for his family to accord with United States standards. See 1 Senate Hearings on H.R. 7378 (Revenue Act of 1942), 77th Cong., 2d Sess., pp. 743-775, and particularly pp. 744, 745, 746, 749, 752, 757, 760, 766, 775.

> citizens who are bona fide residents of foreign countries. * * *
>
> * * * *
>
> In lieu of the repeal of this section, your committee recommends that subsection (a) be amended so as to change the tests there provided to one of residence in a foreign country or countries during the entire taxable year. In the application of such provision, the tests as to whether a taxpayer is a resident of a foreign country or countries will be those generally applicable in ascertaining whether an alien is a resident of the United States. * * * [Italics supplied.]

The House receded from its position and the Senate amendment was accepted. H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 44 (1942-2 Cum. Bull. 701, 708).

Thus, as the statutory language and these excerpts from the hearings and the Committee Reports show, the amended section imposed a new test. The emphasis no longer is upon mere nonresidence, i.e., physical absence from this country. The determinative factor is a showing of a *bona fide* residence in a foreign country, and as the legislative statements indicate, residence there means the maintenance of a real home establishment by a long time foreign resident who assumes the obligations of a home in a foreign country, including the payment of taxes. In accord with the Senate Report's statement that the applicable tests for residence are to be the tests for determining whether an alien is a resident of the United States, Section 29.116-1 of

Treasury Regulations 111 (Appendix, *infra*) provides that in general the question of residence under Section 116(a) is to be determined by appyling the principles of Sections 29.211-2, 29.211-3, and 29.211-4 (all Appendix, *infra*) relating to what constitutes residence or nonresidence in the United States of an alien individual. Of these, Section 29.211-2 contains the provisions here pertinent.

Translating Section 29.211-2 of Treasury Regulations 111 (relating to aliens in the United States) so that it relates to the converse situation here under Section 116(a), it provides that a United States citizen actually present in a foreign country who is not a transient or sojourner is a resident of such foreign country for the purposes of the income tax, and "Whether he is a transient is determined by his intentions with regard to the length and nature of his stay." Under the Regulations, as here pertinent, a citizen is not a transient if he has a mere floating intention, indefinite as to time, to return to the United States, but he is a resident (1) if he lives in a foreign country and has no definite intention as to his stay, and (2) if his purpose in going to the foreign country is of such a nature that an extended stay may be necessary for its accomplishment *and* to that end he makes his home there temporarily even though he may intend to return to his domicile in the United States when the purpose for which he came has been consummated or abandoned.

It is important to observe that the Regulations state as a test for *bona fide* residence not only that the taxpayer must intend to stay indefinitely or for a long time in the foreign country, but also that he must live and

make his home there for the period of his stay. Thus, the Regulations' tests are in accord with the intention of Congress as discussed above.

B. The Record Fully Supports the Tax Court's Findings

In the light of the legislative history of the statute, and the wording of the Regulations, as discussed above, it is clear that the record here clearly supports the finding of the Tax Court that taxpayer was not a *bona fide* resident of Scotland, North Africa, Italy, and France from October, 1942, to December, 1944.

There is nothing in the record to show that the taxpayer established or maintained a home or took on the obligations of a home in any of the foreign countries where he briefly worked. Although he arranged for his own living quarters, his stituation was essentially that of other war workers who were subject to transfer on short notice, and who had no intention to remain permanently, but to return to their homes as soon as their work was finished.

As already indicated, the Regulations prescribe that a citizen must be one who "lives" and "makes his home temporarily" in the foreign country to be entitled to exemption. It is plain that the Regulations use these terms in harmony with the Congressional understanding as reflected in the legislative statements already quoted. Indeed, in *Downs* v. *Commissioner, supra,* (pp. 508-509), this was specifically recognized by this Court and the phrase "make one's home temporarily" in the foreign country was said to mean identifying oneself in some degree with its customs and living under and within such customs. This Court obviously also attrib-

uted the same meaning to the word "lives" in the Regulations. It can hardly be said that the taxpayer identified himself with or lived under and within the customs enforced by any of the countries in which he was a Red Cross worker. During the taxable years he remained in one place only from less than three to approximately ten months, and lived in four different countries.

Inasmuch as taxpayer did not live in any one foreign country for an entire taxable year, he appears to rely upon Section 116(a)(2) of the Code and seeks to establish at least two years' foreign residence. This means that he is asking the Court to find that he was a *bona fide* resident of Great Britain, North Africa (presumably French Morocco), Italy and France, all within a period of twenty-four to twenty-six months.

Taxpayer did not pay taxes to any foreign country during his overseas service, although he was advised by counsel that he owed taxes. (R. 23.) The nonpayment of taxes is a factor of great significance. The Senate Report quoted above indicates that Section 116(a)(1) was designed to protect United States citizens who are resident in a foreign country for periods of years and who are subject to the income tax of that country, and in accord with this purpose the courts have attached weight to the payment of foreign taxes. Thus, in *Harvey* v. *Commissioner,* 10 T.C. 183, 189-190, the Tax Court stated:

> He filled out forms for payment of taxes in Colombia, and the company paid the tax and charged him with it. We regard this one of facts properly to

be considered in examination of the question. We considered it in the *Johnson* case, *supra.* [*Johnson* v. *Commissioner,* 7 T.C. 1040, 1046, 1048.] *Amici curiae* have favored us with a thorough though somewhat repetitive brief directed in part against the idea that payment or nonpayment of taxes abroad is evidential as to foreign residence, yet the brief discloses that the Senate committee report pointed out the subjection of foreign residents to income taxes. That deduction or credit against tax is granted United States citizens for income taxes (and war profits taxes and excess profits taxes) paid foreign countries, under section 131(a)(1), Internal Revenue Code, by no means eliminates tax payments to foreign countries from consideration, on the question of foreign residence. Other foreign taxes, direct or indirect, not the subject of credit or deduction, were considered on this subject by Congress in 1942, evidence of payment of taxes being introduced. Congressional Hearings, Senate Finance Committee, Revenue Act of 1942, pp. 744-746. Though of course not conclusive, we regard the point of taxes paid one to be weighed in determining foreign residence. They were paid by the petitioner. Though it is true that the basis of tax by Colombia was not necessarily residence, the payment, in view of Congress in passage of the act, had significance, and we so consider. It was not the act of a transient, and it is consistent with residence.

Also in *Swenson* v. *Thomas,* 164 F. 2d 783 (C.A. 5th), the payment of Colombian taxes by a geologist long in foreign service unrelated to the war was noted as a factor tending to show residence, and in *Jones* v. *Kyle,* 190 F. 2d 353 (C.A. 10th), certiorari denied, 342 U.S. 886, the nonpayment of Arabian taxes by a United States citizen temporarily present in Arabia on a construction job was mentioned as one factor negativing residence. Cf. *Chidester* v. *United States,* 82 F. Supp. 322, 336 (C. Cls.).

Taxpayer was engaged only in war work for the Red Cross, and had no history of long foreign service in American business apart from this single tour of duty. He was simply temporarily away from his home in the United States, and, according to Senator George's statement, is not entitled to the exemption afforded foreign residents. The fact that he was a war worker under the protection of the American authorities, doubtless with many special privileges not accorded to the citizens of the countries in which he was working, precludes any conclusion that he was establishing a home and living under and within the customs of those countries. Taking into account all the circumstances, it is plain that, athough taxpayer was physically present in four foreign countries during 1943 and 1944, he did not establish and maintain a home there in the sense which Congress contemplated.

In harmony with this view the courts have uniformly held in varying factual situations that war and defense workers do not qualify as *bona fide* residents of a foreign country. See *Downs* v. *Commissioner,* 166 F. 2d 504 (C.A. 9th), certiorari denied, 334 U.S. 832;

Johnson v. *Commissioner,* 7 T.C. 1040; *Love* v. *Commissioner,* 8 T.C. 400; *Chapin* v. *Commissioner,* 9 T.C. 142; *Cruise* v. *Commissioner,* 12 T.C. 1059; *Thorsell* v. *Commissioner,* 13 T.C. 909; *Weeks* v. *Commissioner,* 16 T.C. 248. Cf. *Jones* v. *Kyle, supra.* Conversely, in other cases where the taxpayer has not been engaged merely in war work, but has had a history of foreign service for his employer and has otherwise shown the elements of residence, his status as a bona fide resident of a foreign country has been upheld. *Seeley* v. *Commissioner,* 186 F. 2d 541 (C.A. 2d); *Swenson* v. *Thomas, supra; Myers* v. *Commissioner,* 180 F. 2d 969 (C.A. 4th); *White* v. *Hofferbert,* 88 F. Supp. 457 (Md.); *Wood* v. *Glenn,* 92 F. Supp. 1 (W.D. Ky.); *Rose* v. *Commissioner,* 16 T.C. 232.

Taxpayer's situation was identical with that of the taxpayer in *Cruise* v. *Commissioner, supra.* There, the taxpayer, who held an identical position, and under the same terms, conditions, and restrictions as the taxpayer here, so far as we are advised, lived practically all of the time in England, and testified that he had considered remaining there. The Tax Court found he was not a *bona fide* resident of a foreign country, stating (p. 1063):

> His actions from the time he received his Red Cross appointment clearly indicate that he belongs in the same category as other civilian workers who contributed to the war effort by accepting employment in a foreign country for the duration of the war or a shorter period and after its termination returned to the United States.

The pertinent Regulations state that one is a resident if he has no definite intention as to his stay and if he lives, i.e., makes his home, in the foreign country. Here the taxpayer not only did not make his home in any of the countries in which he temporarily worked, but he had a very definite intention as to his stay. It is important that he did not even resign his position in Washington, but merely took a leave of absence. In fact, he freely admitted that at all times he intended to return. He stated (R. 22):

> And I might state, because I think it is relevant, obviously, and I think it should be stated, that my intention was not to remain away from the United States permanently. My intention—I wish to make it clear, in all fairness—my intention was to return to the United States when and if, I might say, my service with the American Red Cross overseas was completed.
>
> I intended, however, and did intend to remain abroad as long as I was required to remain abroad, whether that might take a year or two years or five years; whatever the exigencies of that particular situation might demand.

Again, on cross-examination, the taxpayer stated (R. 32):

> Q. It was your intention to return to the United States when your tour of duty overseas was finished?
>
> A. Let me put it this way: It was my hope to return to the United States. Yes, certainly, I in-

> tended to return to the United States if I was physically able to do so.

Thus, although the taxpayer's service was indefinite as to time, it was specific in that he was there for only one purpose, to perform the temporary war duties assigned to him by the Red Cross, for which he had obtained a temporary leave of absence. Cf. *Downs* v. *Commissioner, supra,* where Downs' contract was indefinite as to time but he intended to stay in the British Isles for the period required to perform his duties in the construction of aircraft depots under the contract between the United States Government and Lockheed Aircraft Corporation.

Taxpayer contends that his purpose in going overseas was of such a nature that an extended stay might be necessary for its accomplishment. (Br. 26.) But that would not be sufficient to qualify him as a resident within the meaning of the statute as interpreted by the Regulations. The sentence of the Regulations embodying this thought states as a further condition that to that end he must have made his home temporarily in the foreign country. As has been shown, taxpayer did not satisfy this requirement, and therefore he was not a resident under this sentence of the Regulations, any more than under any other.

The cases on which taxpayer relies (Br. 23-27) are all distinguishable on their facts. They are cases in which the individuals involved were not war workers, but long-time foreign service employees of a business corporation with a background of service abroad for a considerable period of years as in *Swenson* v. *Thom-*

as, supra, and *White* v. *Hofferbert, supra.* In *Myers* v. *Commissioner, supra,* the question was as to the precise time at which Myers formed the intention to become a permanent resident of the Bahamas. The court held that the intention was formed near the end of 1942, rather than in 1943 as the Tax Court had held, and thus that Myers was a bona fide resident of Nassau throughout 1943. There was no question that Myers became a bona fide resident, since he moved his family to Nassau, sold his house in the United States, applied to his United States employer for retirement and a pension, and accepted employment with a Nassau corporation. As stated, the only question was as to the time when he became a resident. The court there did not interpret the word "resident" in the statute and Regulations as meaning mere physical presence.

Therefore, it is submitted that the Tax Court's finding that under the evidence taxpayer was not a bona-fide resident of a foreign country or countries during 1943 and 1944 is clearly correct.

II

THE DEFICIENCIES FOR 1943 AND 1944 ARE NOT BARRED BY THE STATUTE OF LIMITATIONS

Taxpayer's income tax returns for 1943 and 1944 were filed on April 28, 1947. The Commissioner's notice of deficiency was mailed on June 19, 1950. Taxpayer contends (Br. 6-19) that the statute of limitations had expired at the time the notice of deficiency was mailed. This depends on which part of Section 275, Internal Revenue Code (Appendix, *infra*), is applicable. If the three-year period of limitations provided in subsection (a) applies, assessment of deficien-

cies was barred. But the Tax Court held, correctly we think, that the five-year statute of limitations provided in subsection (c) applies, so that the notice of deficiency was mailed well within the permissible time.

The question is simply whether, pursuant to the provisions of subsection (c), the Commissioner may assess deficiencies—more than three but less than five years after the filing of the taxpayer's returns—from a taxpayer who improperly claims an exemption from taxation of his entire income, thereby understating his gross income by more than twenty-five percent of the gross income actually stated on the return. It is our position that the Tax Court correctly held that the taxpayer omitted from gross income reported for the years 1943 and 1944 amounts properly includible therein which for each of said years are in excess of twenty-five percent of the amount of gross income stated in the respective returns.

Section 275(c) of the Code provides that if the taxpayer omits from gross income an amount properly includible therein which is in excess of twenty-five percent of the amount of gross income stated in the return, the period of limitations applying to assessment or collection is extended to five years. Taxpayer here stated in the space provided in the returns for listing the source of his income (R. 25)—

> American Red Cross—Overseas Sept. 1942 to Dec. 1944. Income received 3300; exempt under section 116 I.R.C.; therefore no taxable income.

In the space provided for entering the amount of gross income in figures, taxpayer wrote "None". Taxpayer

seeks to remove himself from the effect of the statute by apparently contending that he has included in gross income the full amount of the income received since he has written the figure $3,300 on the face of the return, although he claimed a total exemption, extending into the total income figure nothing at all. Under the plain words of the statute there can be no doubt that the taxpayer has understated his gross income in each return by $3,300.

The taxpayer's brief (Br. 8-12) leaves an erroneous impression of the legislative history of subsection (c). Both the legislative history and the adjudicated cases conclusively demonstrate that the five-year limitation period is clearly applicable to the instant case. The provisions of subsection (c) of Section 275 first appeared in Section 275(c) of the Revenue Act of 1934, c. 277, 48 Stat. 680. The bill originating in the House changed Section 276 of the Revenue Act of 1932, c. 209, 47 Stat. 169, relating to false or no returns and carried no period of limitations. The reason for the provision was stated in a sub-committee report published as part of the House Hearings before the Committee on Ways and Means, 73d Cong., 2d Sess., Revenue Revision of 1934, p. 139, as follows:

> Section 276 provides for the assessment of the tax without regard to the statute of limitations in case of a failure to file a return or in case of a false or fraudulent return with intent to evade tax.
>
> Your subcommittee is of the opinion that the limitation period on assessments should not apply to certain cases where the taxpayer has *under-*

> *stated his gross income* on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government should not be penalized when a taxpayer is so negligent as to leave out items of such magnitude from his return. [Italics supplied.]

The full Committee adopted this reasoning as part of its report, published in H. Rep. No. 704, 73d Cong., 2d Sess., p. 35 (1939-1 Cum. Bull. (Part 2) 554, 580).

The Finance Committee of the Senate incorporated the modification in the same language into Section 275, except that it provided for a five-year period of limitations. It was this provision that was finally enacted into law. In its report (S. Rep. No. 558 (73d Cong., 2d Sess., pp. 43-44 (1939-1 Cum. Bull. (Part 2) 586, 619)) the Committee said:

> The present law permits the Government to assess the tax without regard to the statute of limitations in case of failure to file a return or in case of a fraudulent return. The House bill continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer *understates gross income* on his return by an amount which is in excess of 25 percent of the gross income stated in the return. Your committee is in general accord with the policy expressed in this section of the

> House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases. [Italics supplied.]

See H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 25 (1939-1 Cum. Bull. (Part 2) 627, 634).

It is clear that the Congressional intent was to fix a longer period of limitations where *gross income is understated* by more than twenty-five percent of the amount actually stated in the return regardless of the care and good faith of the taxpayer or how honest his mistake. *Ewald* v. *Commissioner,* 141 F. 2d 750, 753 (C.A. 6th). The House Report shows that the provisions of Section 275(c) were to take care of cases where the taxpayer, "*understates* gross income on his return by an amount which is in excess of 25 percent of the gross income stated in the return." [Italics supplied.] It is not enough that somewhere in the return there appears a figure which should have been correctly incorporated in the amount of gross income stated.

As this Court stated in *O'Bryan* v. *Commissioner,* 148 F. 2d 456, 459-460:

> The mere appearance of the total amount of gross income somewhere on the face of an income

> tax return is not sufficient to prevent an omission within the terms of § 275(c). The government is not required to search carefully throughout a tax return to ascertain some fact which will put it on notice of error. It is apparent from the pertinent legislative history that care and good faith on the part of a taxpayer will not prevent the applicability of subsection (c). *Ewald* v. *Commissioner of Internal Revenue,* 6 Cir., 1944, 141 F. 2d 750, 753. To satisfy the terms of the section, the figure which represents *gross income* and from which net income is derived *must not be understated* by an amount in excess of 25 per cent of the figure. [Italics supplied.]

The Tax Court significantly pointed out (R. 40) that the exact question before the Court here had been decided adversely to the taxpayer's contention in *M. C. Parrish & Co.* v. *Commissioner,* 3 T.C. 119, 130-131, affirmed, 147 F. 2d 284 (C.A. 5th), where the taxpayer had reported in an attached schedule receipt of a certain amount as "Interest collected on State of Texas obligations", but did not return the amount as "Gross Income". The Court stated (pp. 130-131):

> In *Emma B. Maloy,* 45 B.T.A. 1104, we had occasion to construe the term "gross income" as used in section 275(c) of the Revenue Act of 1934, which section is identical with section 275(c) of the Revenue Act of 1936. In the course of our opinion we said:
>
> > * * * We think it evident that the term "gross income" as used in section 275(c), *supra,* refers

> to the statutory gross income required to be reported on the return. The heading, "Gross Income", on the form of the return calls for the inclusion there only of gross taxable income. That amount does not include that portion of capital gain which is not to be taken into account in computing taxable income, nor does it include nontaxable interest on Government securities. Section 275(c) refers to the omission from gross income of an amount "properly includible therein" * * *.
>
> * * * *

Petitioner did not report the amount of $15,512.52 as gross income under section 22(a); it reported the amount as an *exclusion* from gross income under section 22(b)(4). Although an amount may be disclosed fully on the return, if it is not reported as a part of the gross taxable income, it is not a part of the "gross income stated in the return" as that phrase is used in section 275(c), *supra*. *Emma B. Maloy, supra; Estate of C. P. Hale,* 1 T.C. 121; *American Liberty Oil Co.,* 1 T.C. 386; *Katharine C. Ketcham,* 2 T.C. 159; *American Foundation Co.,* 2 T.C. 502. * * * We hold that petitioner omitted from its "gross income stated in the return" the amount of $15,512.52. The amount of "gross income stated in the return" was $11,426.94. Since the amount omitted from gross income was properly includible therein, and since this amount is in excess of 25 percent of the amount of gross income stated in the return, it follows

that the deficiencies for the year 1937 are not barred by the statute of limitations.

Applying the reasoning of the *Parrish* case here, Section 22(b), Internal Revenue Code, provides that certain items shall not be included in gross income and shall be exempt from taxation, and subsection 22(b)(8), Internal Revenue Code (Appendix, *infra*), thereunder provides for such exclusion from gross income and exemption from taxation, to the extent provided in Section 116, of earned income from sources without the United States. This is the authority upon which taxpayer bases his claim of nontaxability. If taxpayer is correct regarding the exemption of his income under Section 116, then such income should be excluded from gross income; if, however, such income is found taxable by this Court, then it is "properly includible therein". With respect to Section 275(c), taxpayer's disclosure of the income claimed exempt from taxation has no legal effect. He is not reporting such income as gross taxable income. His position is necessarily that the income in question is not "properly includible" in his gross income.

In *Ketcham* v. *Commissioner,* 142 F. 2d 996 (C.A. 2d), the taxpayer attached schedules to her return revealing the receipt of trust income in lieu of alimony which she believed was taxable to her husband. The court held that part of the trust income was taxable to her and that the schedules did not relieve her from the effect of having omitted such amount of gross income. In *Reis* v. *Commissioner,* 142 F. 2d 900 (C.A. 6th), the taxpayer revealed sales and proceeds thereof,

but his basis was improperly computed and no gain was included in the amount extended into gross income. Since the gain properly computed exceeded twenty-five percent of the taxpayer's stated gross income, Section 275 (c) was invoked to offset the bar that otherwise would have been imposed by the statute of limitations.

Taxpayer's claim of exemption resulted in a failure to include any amount of gross income stated in the returns. Assuming that this Court agrees with the Commissioner's position that the income was properly includible in the returns, taxpayer understated his income by one hundred percent, rather than by twenty-five percent.

The taxpayer argues (Br. 16) that the Commissioner was fully informed as to the amount he earned, and that in such circumstances Section 275(c) is without application. That fact makes no difference here. The report of the Senate Finance Committee from which we have quoted above shows plainly that Congress had just such a situation as the instant one in mind when it passed the five-year statute. Section 275(c) contains no exception as to cases where the Commissioner is acquainted with the facts, and it is clear that none should be read into it.

The cases of *Uptegrove Lumber Co.* v. *Commissioner,* 204 F. 2d 570 (C.A. 3d), and *Van Bergh* v. *Commissioner,* 18 T.C. 518, on which taxpayer relies (Br. 12-14, 17-18) are clearly distinguishable on their facts. Moreover, to the extent that the *Uptegrove* case may be considered authority for the taxpayer's position here, it is submitted that it is clearly wrong, and should not be

followed by this Court. *O'Bryan* v. *Commissioner, supra; M. C. Parrish & Co.* v. *Commissioner, supra.*

The Congressional intent is clear from the plain and unambiguous language of the statute. In the light of its provisions, and the decided cases by this and other courts, the conclusion is compelled that the Tax Court was clearly correct in finding that taxpayer omitted from gross income reported in the taxable years amounts properly includible therein which are in excess of twenty-five percent of the amount of gross income stated in the returns, and, therefore, that the five-year statute of limitations in subsection (c) of Section 275 of the Code is clearly applicable.

CONCLUSION

The decision of the Tax Court was correct on both issues and should be affirmed.

Respectfully submitted,

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February, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

* * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * *

(8) *Miscellaneous items.*—The following items, to the extent provided in section 116:

Earned income from sources without the United States;

* * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

(a) *Credits for Normal Tax Only.*—There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

* * * *

(4)[5] *Earned income definitions.*—For the purposes of this section—

(A) "Earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include any amount not

[5] This subsection was repealed by Section 107(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, as to taxable years beginning after December 31, 1943.

included in gross income, nor that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

* * * *

(26 U.S.C. 1940 ed., Sec. 25.)

SEC. 116 [As amended by Sec. 148(a), Revenue Act of 1942, c. 619, 56 Stat. 798]. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) *Earned Income From Sources Without the United States.*—

(1) *Foreign resident for entire taxable year.*—In the case of an individual citizen of the United States, who establishes to the satisfaction of the Commissioner that he is a bona fide resident of a foreign country or countries during the entire

taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts would constitute earned income as defined in section 25(a) if received from sources within the United States; but such individuals shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(2) *Taxable year of change of residence to United States.*—In the case of an individual citizen of the United States, who has been a bona fide resident of a foreign country or countries for a period of at least two years before the date on which he changes his residence from such country to the United States, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof), which are attributable to that part of such period of foreign residence before such date, if such amounts would constitute earned income as defined in section 25(a) if received from sources within the United States; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

* * * *

(26 U.S.C. 1946 ed., Sec. 116.)

SEC. 119. INCOME FROM SOURCES WITHIN THE UNITED STATES.

* * * *

(c) *Gross Income from Sources Without United States.*—The following items of gross income shall be treated as income from sources without the United States:

* * * *

(3) Compensation for labor or personal services performed without the United States;

* * * *

(26 U.S.C. 1946 ed., Sec. 119.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * *

(c) *Omission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without

assessment, at any time within 5 years after the return was filed.

* * * *

(26 U.S.C. 1946 ed., Sec. 275.)

Revenue Act of 1943, c. 63, 58 Stat. 21:

SEC. 107. REPEAL OF EARNED INCOME CREDIT.

* * * *

(b) *Earned Income From Sources Without United States.*—Section 116(a) (relating to earned income from sources without the United States) is amended (1) by striking out "if such amounts would constitute earned income as defined in section 25(a) if received from sources within the United States" appearing in paragraphs (1) and (2) and inserting in lieu thereof "if such amounts constitute earned income as defined in paragraph (3)"; and (2) by inserting at the end thereof the following new paragraph:

"(3) *Definition of earned income.*—For the purposes of this subsection, 'earned income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal

services and capital are material income producing factors, under regulations prescribed by the Commissioner with the approval of the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income."

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.116-1.[6] *Earned Income From Sources Without the United States.*—For taxable years beginning after December 31, 1942, there is excluded from gross income earned income in the case of an individual citizen of the United States provided the following conditions are met by the taxpayer claiming such exclusion from his gross income: (a) it is established to the satisfaction of the Commissioner that the taxpayer has been a bona fide resident of a foreign country or countries throughout the entire taxable year; (b) such income is from sources without the United States; (c) the income constitutes earned income as defined in section 25(a) if received from sources within the United States; and (d) such

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[6] This section was amended by T.D. 5373, 1944 Cum. Bull. 143, so as to refer to earned income as defined in Section 25(a), Internal Revenue Code, for taxable years beginning before January 1, 1944; and for taxable years after December 31, 1943, to refer to the definition of earned income in Section 116(a)(3), in accordance with the amendment contained in Section 107 of the Revenue Act of 1943, *supra*.

income does not represent amounts paid by the United States or any agency or instrumentality thereof. Hence, a citizen of the United States taking up residence without the United States in the course of the taxable year is not entitled to such exemption for such taxable year. However, once bona fide residence in a foreign country or countries has been established, temporary absence therefrom in the United States on vacation or business trips will not necessarily deprive such individual of his status as a bona fide resident of a foreign country. Whether the individual citizen of the United States is a bona fide resident of a foreign country shall be determined in general by the application of the principles of sections 29.211-2, 29.211-3, 29.211-4, and 29.211-5 relating to what constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual.

* * * *

Sec. 29.211-2. *Definition.*—A "nonresident alien individual" means an individual—

(a) Whose residence is not within the United States; and

(b) Who is not a citizen of the United States.

The term includes a nonresident alien fiduciary.

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of

his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

Sec. 29.211-3. *Alien Seamen, When to be Regarded as Residents.*—

* * * *

Sec. 29.211-4. *Proof of Residence of Alien.*—The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of chapter 1. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumpiton may be overcome—

(1) In the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (a) proof that the alien,

at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (b) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (c) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident;

(2) In other cases by (a) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (b) proof that the alien has filed Form 1078 or its equivalent, or (c) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.

In any case in which an alien seeks to overcome the presumption of nonresidence under (1)(c) or (2)(c), if the internal-revenue officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits.

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